



Joint Legislative Audit Committee
Office of the Auditor General



FINANCIAL AUDIT REPORT
DEPARTMENT OF SAVINGS AND LOAN
YEAR ENDED JUNE 30, 1977

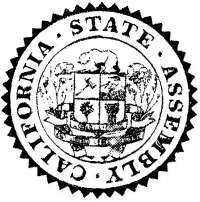
The regulations of the Federal Office of Revenue Sharing require governments receiving revenue sharing funds to have audits of their financial statements not less than once every three years. This audit assists in fulfilling the audit requirements necessary to continue California's eligibility for federal revenue sharing funds.

Our examination was made in accordance with generally accepted auditing standards and included studying and evaluating the Department's system of internal control. This study and evaluation disclosed several conditions which we believe to be weaknesses and were considered in determining the nature, timing, and extent of our audit tests. Presentation of these conditions, however, does not modify our opinion on the financial statements.

REPORT TO THE
CALIFORNIA LEGISLATURE

REPORT OF THE
JOINT REVENUE SHARING TASK FORCE
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE
AND
DEPARTMENT OF FINANCE

FINANCIAL AUDIT REPORT
DEPARTMENT OF SAVINGS AND LOAN
YEAR ENDED JUNE 30, 1977



Joint Legislative Audit Committee

OFFICE OF THE AUDITOR GENERAL

California Legislature



CHAIRMAN
RICHARD ROBINSON
SANTA ANA

ASSEMBLYMEN
DANIEL BOATWRIGHT
CONCORD

EUGENE A. CHAPPIE
ROSEVILLE

MIKE CULLEN
LONG BEACH

RICHARD ROBINSON
CHAIRMAN

VICE CHAIRMAN
ALBERT RODDA
SACRAMENTO

SENATORS
PAUL CARPENTER
CYPRESS

GEORGE DEUKMEJIAN
LONG BEACH

NATE HOLDEN
LOS ANGELES

October 2, 1978

The Honorable Speaker of the Assembly
The Honorable President pro Tempore of the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully forwards the Auditor General's financial audit of the Department of Savings and Loan. This is the first audit in response to the regulations of the Federal Office of Revenue Sharing requirement that governments receiving revenue sharing funds have audits of their financial statements not less than once every three years. This audit assists in fulfilling the audit requirements necessary to continue California eligibility for federal revenue sharing funds.

The Department has implemented several of the recommendations and is complimentary of our staff in its response.

Respectfully submitted,



RICHARD ROBINSON
Chairman, Joint Legislative
Audit Committee

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. AUDITOR'S OPINION	2
III. FINANCIAL STATEMENTS	
COMBINED BALANCE SHEET	3
SAVINGS AND LOAN INSPECTION FUND	
TRUST ACCOUNT	
GENERAL FIXED ASSETS	
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE	4
SAVINGS AND LOAN INSPECTION FUND	
IV. NOTES TO FINANCIAL STATEMENTS	5
V. COMMENTS AND RECOMMENDATIONS	8
VI. AUDIT ADJUSTMENTS	13
VII. RESPONSE TO THE JOINT REVENUE SHARING TASK FORCE'S REPORT	
DEPARTMENT OF SAVINGS AND LOAN	14

INTRODUCTION

In compliance with regulations promulgated by the Federal Office of Revenue Sharing, we have conducted a financial audit of the Department of Savings and Loan. This audit was conducted under the authority vested in the Auditor General by Government Code Section 10527 and the Department of Finance by Government Code Section 13294.

The principal objectives of the Department of Savings and Loan are to protect the funds of the saving and investing public held by state-licensed associations, to assure associations' compliance with consumer protection and anti-discrimination laws and regulations, and to assure the continued financial growth of these associations consistent with public need and convenience.

The programs of the Department of Savings and Loan are supported by the Savings and Loan Inspection Fund. The Savings and Loan Inspection Fund is replenished annually by assessment of savings and loan associations, license fees, income from investment of surplus money and charges for specific services.

AUDITOR'S OPINION

To the Joint Legislative Audit Committee of the California Legislature
and the Department of Finance:

We have examined the combined balance sheet of the Department of Savings and Loan as of June 30, 1977, and the related statements of revenues, expenditures, and changes in fund balances for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

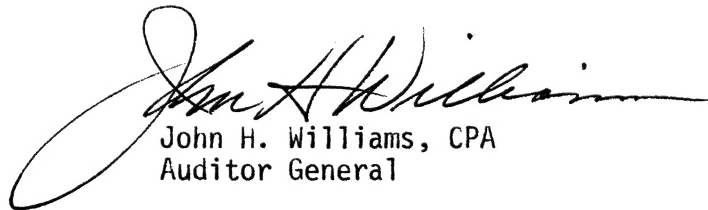
In our opinion, these financial statements present fairly the financial position of the Department of Savings and Loan at June 30, 1977, and the results of its operation and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The column amounts on the accompanying combined balance sheet captioned "Total - Memorandum Only" for June 30, 1977, are not necessary for a fair presentation of the financial statements, but are presented as additional analytical data and in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

The column amounts on the accompanying combined balance sheet and statement of revenues, expenditures, and changes in fund balance for the year ended June 30, 1976, which are presented for comparative purposes only, were not audited by us and accordingly we do not express an opinion on them.

In connection with our examination, we also made a study and evaluation of the Department of Savings and Loan's system of internal accounting control. Our findings are set forth under the heading "Comments and Recommendations" in this report.

Revenue Sharing Task Force



John H. Williams, CPA
Auditor General

Date: June 23, 1978

Staff: Curt Davis, CPA
Michael C. Dendorfer
Sandra R. McHaney
Richard R. Sanchez

DEPARTMENT OF SAVINGS AND LOAN
COMBINED BALANCE SHEET
ALL FUND TYPES AND ACCOUNT GROUPS

JUNE 30, 1977
(With Unaudited Amounts for 1976)

	Governmental Fund Savings and Loan Inspection	Fiduciary Fund Trust Account	Account Group General Fixed Assets	TOTAL (Memorandum Only)	
ASSETS				June 30, 1977	June 30, 1976
Cash	\$ 471,376			\$ 471,376	\$ 113,235
Security Guaranty Deposits Held in Trust for Savings and Loan Associations		\$243,113		243,113	258,461
Deposits in Surplus Money					
Investment Fund	1,364,500			1,364,500	817,500
Accounts Receivable	1,611			1,611	-0-
Due from Surplus Money					
Investment Fund	68,650			68,650	44,961
Prepayments to Other Funds	8,400			8,400	27,364
Expense Advances to Employees	7,794			7,794	1,847
Other Deferred Charges	230			230	
Equipment			\$197,048	197,048	160,556
TOTAL ASSETS	\$1,922,561	\$243,113	\$197,048	\$2,362,722	\$1,423,944
LIABILITIES, ENCUMBRANCES OUTSTANDING, AND FUND EQUITY					
Liabilities:					
Accounts Payable (Note 2)	\$ 126,074			\$ 126,074	\$ 97,455
Liability for Installment Purchase Contracts (Note 3)			\$ 3,080	3,080	
Revenue Collected in Advance	377,910			377,910	379,800
TOTAL LIABILITIES	503,984		3,080	507,064	477,255
Encumbrances Outstanding (Note 4)	108,893			108,893	92,571
Fund Equity:					
Investment in General Fixed Assets			193,968	193,968	160,556
Fund Balance	1,309,684	\$243,113		1,552,797	693,562
TOTAL FUND EQUITY	1,309,684	243,113	193,968	1,746,765	854,118
TOTAL LIABILITIES, ENCUMBRANCES OUTSTANDING AND FUND EQUITY	\$1,922,561	\$243,113	\$197,048	\$2,362,722	\$1,423,944

The notes to the financial statements are an integral part of this statement.

DEPARTMENT OF SAVINGS AND LOAN
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL
Savings and Loan Inspection Fund
FOR THE FISCAL YEAR ENDED JUNE 30, 1977
(With Unaudited Amounts for 1976)

	1977		1976
	Budget As Adjusted	Actual	Actual
			Over (Under) Budget
<u>Sources of Financial Resources:</u>			
Revenues:			
Savings and Loan Licenses and Fees	\$5,263,062	\$5,302,512	\$ 39,450
Income from Surplus Money			
Investment	100,000	133,094	33,094
Miscellaneous Income	<u>1,000</u>	<u>1,003</u>	<u>3</u>
Total Revenues <u>a/</u>	5,364,062	5,436,609	72,547
Other Sources:			
Reimbursements	25,000	1,663	(23,117)
Refunds to Reverted Appropriation		<u>199</u>	<u>199</u>
Total Sources of Financial Resources	5,389,062	5,438,811	49,629
<u>Uses of Financial Resources:</u>			
Expenditures:			
Current:			
Personal Services	3,959,259	3,633,741	(325,518)
General Expense	145,168	134,275	(10,893)
Communications	84,019	54,291	(29,728)
Travel-in-State	293,424	286,267	(7,157)
Travel-out-of-State	33,820	3,474	(30,346)
Consultant Services	0	0	0
Facilities Operation	152,496	145,600	(6,896)
Data Processing	303,358	102,468	(201,390)
Pro Rata Charges	98,328	95,352	(2,976)
Equipment	69,776	53,005	(16,771)
Consolidated Data Center	45,600	31,368	(14,232)
Board of Control Claims, Chapter 381/76		64	64
Prior Year:			
Prior Year Appropriation Adjustments		(5,797)	(5,797)
Total Uses of Financial Resources	5,205,748	4,564,103	(641,640)
Net Increase (Decrease) in Fund Balance during the Year	183,314	874,583	
Fund Balance - July 1	435,101	435,101	
Fund Balance - June 30	\$ 618,415	\$1,309,684	\$ 435,101

a/ Revenues are not budgeted in the legislative budget bill. The amounts shown on this statement are agency budgeted revenue amounts that are shown in the Governor's Annual Budget.

The notes to the financial statements are an integral part of this statement.

DEPARTMENT OF SAVINGS AND LOAN
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 1977

1. Summary of Significant Accounting Policies

The preceding financial statements reflect the financial position and results of operations of the Department of Savings and Loan. The accounts are maintained in the Savings and Loan Inspection Fund and a Trust Account for securities held as guaranty deposits.

The accounting policies of the Department of Savings and Loan conform to generally accepted accounting principles as applicable to governmental units and as contained in the State Administrative Manual.

Savings and Loan Inspection Fund

The Savings and Loan Inspection Fund is used to account for all revenues collected and the costs of administering the laws governing state-licensed savings and loan associations.

Income: Throughout the fiscal year, income is accounted on a cash basis, except appropriation reimbursements which are recorded when billed. At June 30, the accounts are adjusted to a modified accrual basis. All earned but uncollected revenues and unbilled reimbursements are accrued, except revenue receivables estimated not to be collectible within one year which are fully reserved.

Expenditures: During the fiscal year, expenditures are accounted on a claims filed (with the State Controller) basis. Valid expenditure

commitments are accrued at June 30.

Trust Account

The Trust Account is a depository for securities received as guaranty deposits by out-of-state savings and loan associations operating branches within California.

Liabilities

Retirement Plan: Regular employees of the Department of Savings and Loan are members of the Public Employees' Retirement System (PERS) which is a defined benefit, contributory retirement plan. The amount the agency and employees contribute to PERS is actuarially determined under a program in which contributions plus retirement system earnings provide the necessary funds to pay retirement costs as accrued. Retirement contributions for the year included in the expenditures-personal services account were \$406,751.

Vacation and Sick Leave: The Department does not record the costs of vacation and sick leave at the time the benefits are accumulated. At the time of usage, the expenditures-personal services account is charged.

General Fixed Assets: Purchases of equipment are recorded as expenditures in the year of acquisition. The aggregate cost, with the exception of certain non-expendable equipment items not on the State Administrative Manual equipment list, is capitalized in the General Fixed Assets account group. Non-expendable equipment, generally valued at

\$150 or over with a useful life of two years or more, is recorded at original cost, or, if not available, at fair market value. No depreciation has been provided for equipment.

2. Accounts Payable

Accounts payable include all unpaid liabilities for goods and services received as of June 30, 1977. Accordingly, they also include liabilities whose disbursement requests were submitted to the State Controller by June 30, 1977 ("claims filed"), but which he had not paid as of that date.

3. Liability for Installment Purchase Contract

This account shows the liability for future installment payments on fixed assets purchased under a installment purchase contract.

4. Encumbrances Outstanding

Encumbrances outstanding include all valid commitments against budget appropriations for which no goods or services had been received by June 30, 1977.

COMMENTS AND RECOMMENDATIONS

As part of our examination we made a study of the Department of Savings and Loan's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. Under these standards, the purpose of such evaluation is to establish a basis for reliance on the system of internal accounting control in determining the nature, timing and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements and to assist in **planning** and performing the examination of the financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to (1) the safeguarding of assets against loss from unauthorized use or disposition, and (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstood instructions, mistaken judgment, carelessness or other personal factors. Control procedures whose effectiveness depends upon

segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management either with respect to executing and recording transactions or with respect to the estimates and judgments required in preparing financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

Our examination of the financial statements was made in accordance with generally accepted auditing standards. This included studying and evaluating the Department of Savings and Loan's system of internal accounting control for the year ended June 30, 1977. This study and evaluation was designed for the purposes set forth in the first paragraph of this report and would not necessarily disclose all weaknesses in the system because it was based on selective tests of accounting records and related data. However, such study and evaluation disclosed the following conditions which we believe to be weaknesses.

Separation of Duties Over Cash Transactions Are Inadequate

The separation of duties of employees handling cash transactions do not comply with the State Administrative Manual (SAM) section 8080.

In our opinion, the most serious weaknesses over the separation of duties involving cash transactions are:

- The person who authorizes disbursements also has the authority to sign checks

- The person who prepares the checks also mails or distributes the checks. SAM section 8080 states:

"Checks will not be routed for mailing or distribution through the person who authorized the disbursement or prepared the check."

- The person who prepares and mails or distributes the checks also maintains the disbursement register, controls blank check stock and has access to the safe.

Recommendation: Cash receipt and disbursement duties be separated as prescribed by SAM section 8080.

Performance Bonds Are Not Reviewed Periodically

The Department is not currently reviewing Faithful Performance Bonds to determine if bonding coverage should be in excess of the amount covered under the State's blanket bond. This review is required by SAM section 2582.

Recommendation: Performance bonds be reviewed periodically for adequacy of coverage in accordance with SAM section 2582.

Cash Receipts Are Recorded on Dates Different from the Dates of Actual Receipt

Tests of cash receipts disclosed instances where the date of posting the receipt in the cash receipt register was different from the date of actual receipt. Good internal control procedures call for the recording of cash receipts on the date of actual receipt.

Recommendation: Cash receipts be recorded on the date of actual receipt.

Separation Payments Are Inadequately Documented

Six of 13 separation payments were reviewed for determination of proper payment amounts for accumulated vacation and overtime. The sample revealed two employees whose payments for accumulated vacation and overtime could not be verified because of inadequate documentation.

Recommendation: Adequate documentation be maintained to support separation payments.

Bank Reconciliation Procedures Need Strengthening

The Department's bank reconciliation procedures do not provide for:

- Examination of paid checks for suspicious or irregular features (SAM 8041.1)
- Written acknowledgement for questionable endorsements (SAM 8041.1)
- Review of the bank reconciliation by responsible officers (SAM 7921 and 8080).

Recommendation: The Department strengthen its bank reconciliation process by complying with SAM sections 7921, 8041.1 and 8080.

Undeposited Cash Is Inadequately Safeguarded

The Department does not restrict access to its safe to a limited number of employees and the combination to the safe is not changed with a

change in personnel.

Access to the safe is not restricted to permanent employees.

A student assistant was allowed to remove documents from the safe.

The Department also does not adequately safeguard funds enroute to the bank as required by SAM section 8030.4. Under current procedures, an employee walks an envelope to the bank every afternoon. The amount of checks can total several hundred thousands of dollars a day on occasion, which is large enough to warrant a courier service.

Recommendation: The Department restrict access to the safe to a limited number of employees, change the safe combination with a change in personnel and safeguard funds enroute to the bank by complying with SAM section 8030.4.

Property Accounting Needs Strengthening

The Department's property accounting system does not provide for:

- Sequential numbering of equipment items (SAM 8637)
- Maintenance of a property ledger to keep track of all equipment items (SAM 8654.1)
- A method to dispose of surveyed equipment (SAM 8656).

Recommendation: The Department comply with SAM sections 8637, 8654.1 and 8656.

The foregoing conditions were considered in determining the nature,

timing and extent of audit tests to be applied in our examination of the financial statements, and this presentation of such conditions does not modify our opinion report on such financial statements.

AUDIT ADJUSTMENTS

The aforementioned financial statements contain adjustments to the following accounts:

- Accounts Receivable
- Equipment
- Liability for Installment Purchase Contracts
- Encumbrances Outstanding
- Fund Balance
- Expenditures
- Prior Year Appropriation Adjustments.

The adjustments were necessary to correct the Department's accrual entries. The Department concurred with the suggested journal entries and accordingly adjusted the financial records to reflect those adjustments.

DEPARTMENT OF SAVINGS AND LOAN

600 S. COMMONWEALTH AVENUE, LOS ANGELES, CALIF. 90005 213-736-2798
350 SANSOME STREET, SAN FRANCISCO, CALIF. 94104 415-557-3666



San Francisco
September 26, 1978

John H. Williams, Auditor General
Office of the Auditor General
925 L Street - Suite 750
Sacramento, California 95814

Re: Financial Audit 1976/1977

Dear Mr. Williams:

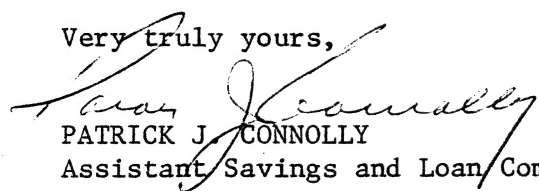
Thank you for your letter of September 20, 1978, enclosing copies of your draft report of the recently completed financial audit of the Department of Savings and Loan for the year ended June 30, 1977. The report has been reviewed by various members of our staff and we are in general agreement with your findings. In many instances, we have already implemented a number of the recommendations described in the "Comments and Recommendations" section as a result of discussions with your auditors. For your information, the following corrective action has taken place:

1. The person signing checks is not allowed to authorize disbursements.
2. Performance bonds are reviewed annually when paid.
3. Cash receipts are being recorded on the dates of actual receipt when received in San Francisco; if received in Los Angeles, they are recorded on a timely basis allowing for courier delivery.
4. Access to the safe has been limited and the combination changed.
5. A property ledger has been established.

For the remaining recommendations, we are studying the feasibility of either changing our procedures or developing alternatives to strengthen our controls.

In closing, I wish to point out that your audit team consisting of Michael Derndorfer, Sandra McHaney and Richard Sanchez performed their duties in a courteous, professional manner and were very helpful in providing information to our accounting department.

Very truly yours,


PATRICK J. CONNOLLY
Assistant Savings and Loan Commissioner

PJC:bms

Office of the Auditor General

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
Secretary of State
State Controller
State Treasurer
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
California State Department Heads
Capitol Press Corps